

admit is that many of these cost savings have been available to them for some time, spanning much of the period since the existing regulatory policies were initiated in the mid 1980s. Instead they attribute this decline in asset values solely to the eventual entry of new competitors.

Incumbent LECs have had extensive opportunities to reduce the value of their assets. According to an analysis by Selwyn and Kravtin, incumbent LECs acquired approximately 65% of their historic book investment between the beginning of 1990 and the end of 1996.⁴² Had incumbent LECs used this opportunity to invest in the amount and mix of available technologies most appropriate for providing telephone service they could have eliminated 65% of this portion of the existing gap (i.e. the difference between the value of embedded assets and forward looking assets).

At the rate of replacement indicated by this estimate, the remaining 35% of their book investment could be replaced by the end of the year 2000. Thus, if incumbent LECs had taken the opportunity to invest in the most efficient mix and scale of technologies beginning in 1990, they would have been able to have an efficient, low-cost telephone network in place before they would be required to face widespread facilities-based competition for local service, simply by replacing plant at historical rates of replacement.

⁴² AT&T Comments, Appendix B, Lee Selwyn and Patricia Kravtin, ETI, Inc., "Assessing Incumbent LEC Claims to Special Revenue Recovery Mechanisms," at v. (ETI Report)

Incumbent LECs have not used this time to make their local service more efficient. Rather than invest in the most efficient local service assets, they have chosen to invest in unregulated ventures and assets not required to provide telephone service.⁴³ One now understands the urgency of their plea to be made whole. Having squandered seven years on other tasks that have not benefitted regulatory ratepayers, such as entry into video, the LECs now propose using projection lives 30-40% shorter than they have historically utilized. (See Table IV-1 below) The Commission should not now reward incumbent LECs for what is at best poor business judgment, and at worst, outright subsidization of unregulated ventures by regulated customers.

⁴³ Selwyn and Kravtin estimate that 30% of RBOCs net book investment was unnecessary for the provision of telephone service.

Table IV-1 LEC Proposed Acceleration of Depreciation Projection Lives			
Account	Proposed Average Projection Life	FCC PreApproved Average Projection Life	Percentage Reduction Proposed
Digital Switching	10 years	17 years	41%
Digital Circuit	8.5 years	12 years	29%
Metallic Cable	15 years	24.5 years	39%
Fiber	17.5 years	27.5 years	36%

Sources: a) TFI Report, USTA Attachment 14.
b) Simplification of the Depreciation Prescription Process, CC Docket No. 92-266, 9 FCC Rcd 3206, Appendix B, Second Report and Order.

**C. Future Revenues Must Mitigate Recovery of Those Assets
Determined to be Stranded.**

Incumbent LEC arguments in support of recovering assets stranded due to their obligations to serve and unrecovered depreciation shortages do not withstand scrutiny. They fail to identify specific assets for which they did not receive an opportunity to completely recover its value due to policies imposed by regulators.

Even if one were able to identify LEC stranded assets, LECs would not be entitled to include the full difference between the remaining embedded value and its economic value in a transition fund. The recovery of transition costs is not directly linked to the asset's replacement with new technology, when investment in a new asset may have been motivated by the incumbent LECs desire to offer

non-regulated services. Supposedly stranded assets would be able to generate revenues from customers of existing services for some years.⁴⁴

For example, copper cable distribution that supposedly will be stranded by fiber still retains value. It might be possible to resell the copper plant to other carriers offering plain old telephone service, rather than broadband-enhanced services. The plant is not technologically obsolete for plain old telephone service, so there is no need to mitigate any “stranded” assets even if they are not reused.

The Commission should adopt a broad view when it estimates the value of stranded assets. Not only should the value of such assets, if any, be reduced by the discounted present value of all future regulated and unregulated net revenues they are capable of earning, they should also be reduced by the value of all assets that have been moved from regulated to unregulated activities, such as yellow pages and directory assistance. In addition, the Commission should reduce the value of stranded assets by the value of any “sunk regulatory benefits,” including, for example, all net revenues, past, present, and future earned from the allocation of free cellular spectrum granted to the incumbent LECs.

Such asset values were either originally recovered from regulated

⁴⁴ Increased demand through long distance rate cuts and the phenomenal growth of second lines cited in MCI's initial comments are just two examples. MCI Comments at 4, n. 9.

ratepayers, and/or have retained much of their value by association with the regulated carrier. The Commission should offset stranded asset values by the net discounted present value of all “goodwill” conferred by regulated activities on the incumbent LECs unregulated businesses.

D. The Commission must Rigorously Estimate All Sources of Future Revenues, Cost Savings, and Require LECs Qualifying for Recovery of Stranded Assets to Adhere to a Plan of Action Maximizing the Revenues and Cost Savings.

Once an asset has been identified as having been stranded due to Commission-imposed policy, the Commission then must establish its market value. It may do this by forecasting expected net cash flows generated by the asset. The Commission should consider all sources of future revenue, as well as all feasible cost saving measures the LEC might take in its use of this asset. Since compensation for a stranded asset involves a social recognition that the asset is no longer fully functional, its use should be treated akin to a bankruptcy reorganization. The Commission would be in the role of a trustee with regard to the asset in question, and would be mandated to reorganize the portion of the company making use of the stranded asset, in order to maximize revenues and cost savings.

E. Increasing Depreciation Rates to Recover Legitimate Transition Costs Would Be Anticompetitive as Well as Administratively Impossible.

Once all mitigation attempts with regard to assets legitimately found to have been stranded have been taken, the remaining unrecovered value, if any, should be recovered in a competitively neutral fashion. Allowing the incumbent LECs to recover these costs by increasing depreciation rates above forward looking competitive levels and reflect these depreciation rates in higher prices would be very anticompetitive since it would apply to all assets of the incumbent LEC, not just the stranded asset in question. This would allow incumbent LECs to overcharge for key inputs used by competitors, raising their costs and preventing them from competing fairly.

In addition, once the Commission altered depreciation rate-setting to account for discrepancies between the depreciated book value of assets and their forward looking market value, it would find itself having to evaluate LEC claims of changing market values for many asset categories every year, and then adjusting depreciation rates on an annual basis. Moreover, since forward looking market values of assets might vary widely among LECs, the Commission might be required to assign widely varying depreciation rates for every LEC.

V. SEPARATIONS AND RATE STRUCTURE ISSUES

A. Misallocation of Costs Does Not Explain Excessive Access Charges.

The incumbent LECs argue that Part 36 Separations rules have assigned costs to the interstate jurisdiction in excess of the costs that truly should be assigned there. USTA cites a number of examples: (1) the allocation of 25 percent of loop costs to the interstate jurisdiction, even though the interstate jurisdiction has only about 15 percent of total minutes; (2) the allocation of marketing expenses between the jurisdictions based on total revenues rather than revenues less access, which allocates about 26 percent of incumbent LEC marketing expenses to the interstate jurisdiction even though very few of the marketing functions are used to provide access services; and (3) the assignment of interexchange circuit equipment and cable and wire facilities on the basis of allocation factors rather than direct assignment, which raises the allocation of costs to the interstate jurisdiction by about \$220 million.⁴⁵ The incumbent LECs claim that these allocations were adopted to reduce intrastate rates, including local rates, and that because these costs are assigned to the interstate jurisdiction by Separations they must continue to be recovered in access charges.

⁴⁵ See USTA Comments, Attachment 2, "Implications of the Separations Legacy for Implementation of the Telecommunications Act of 1996," James Fischer, Albert P. Halprin, Henry M. Rivera and Marvin R. Weatherly, at 25-33.

It is important to note that the Part 36 Separations rules allocate incumbent LEC expenditures, not their costs. The amount the incumbent LECs currently spend to provide service is not necessarily the economically efficient level. Indeed, given the absence of effective competition, and the price cap plan that does not effectively pass through to ratepayers the changes in the incumbent LECs costs, it is very likely that the incumbent LECs' expenditures are above the economically efficient level. This is evidenced by the fact that the results of the Hatfield model detailed in MCI's comments indicate that the incumbent LECs interstate access rates are currently approximately \$10 billion above their true cost. Nothing in the Separations rules requires the incumbent LECs to spend this excessive amount.

Even if too many expenses are assigned to the interstate jurisdiction, this can only be a hardship on the incumbent LEC if their intrastate rates are also below their economic costs. This is in general not the case. The Hatfield results, for instance, show that the total economic cost of local service is about \$22.4 billion.⁴⁶ Since incumbent LEC local service revenues in 1995 were almost \$34 billion, the incumbent LECs are clearly not charging less than the cost of providing local service.

The only situation in which incumbent LEC rates may be below their costs is in those few high-cost areas where the local rates are below their costs.

⁴⁶ As reported in MCI's comments, the interstate portion (25 percent) of the loop cost is \$5.6 billion. The state portion is therefore \$16.8 billion.

However, the universal service fund mandated by the 1996 Act and which the Commission is considering will be designed precisely for this situation: where local costs are above a politically acceptable rate, all interstate telecommunications carriers will be required to contribute to the fund to pay the difference between that rate and the costs. The Hatfield model estimates that this fund will need to be approximately \$5.3 billion. Thus, even in those few situations where the incumbent LEC's prices are below costs, there will be a mechanism -- the universal service fund -- to reimburse the incumbent LEC for the difference. With the completion of the universal service proceeding, there will be no justification for allowing the incumbent LEC to charge above-cost access rates to subsidize high cost consumers.

B. The TIC Should Be Eliminated, Not Renamed.

The incumbent LECs argue that there are costs currently in the TIC that can be properly assigned to other rate elements. Once those costs have been removed, the incumbent LECs state, the remainder of the TIC should be recovered in a new public policy element.⁴⁷ The Commission has indicated that the TIC was intended to be transitional in nature until the specific, legitimate costs, if any, could be properly identified.⁴⁸

As MCI explained in its comments, the problem is that the TIC is an

⁴⁷ See, e.g., Southwestern Bell Comments at 10; US West Comments at 72.

⁴⁸ Transport Rate Structure and Pricing, Report and Order and Further Notice of Proposed Rulemaking, 7 FCC Rcd 7006 at para. 133. (1992)

uneconomic, unnecessary, make-whole charge that should be eliminated.

Regardless of what shape access reform ultimately takes, there is no economic basis for simply reallocating costs to various rate elements, computing the residual and renaming it a public policy element. The TIC is a tax on all users of the incumbent LEC network, including the LECs' competitors. If the Commission does not eliminate this rate element, new entrants will be forced to pay an indefensible subsidy to their new competitors. The incumbent LECs' current revenue stream, which was originally determined under regulation, should not be effectively insulated from competitive pressures.

C. Local Rate Increases Are Not Necessary.

As argued above, no local rate increases are necessary to ensure that incumbent LECs are able to recover their economic costs of providing service when access charges are lowered to cost. MCI has estimated that access charges should be cut by more \$10 billion to set them at economic cost.⁴⁹ The incumbent LECs claim that cuts of that magnitude would either require increases in local rates or cause a drastic drop in their earnings.

The New York Department of Public Service (NY PSC) provides an analysis in its comments that shows that "interstate access charge reductions in excess of 50% should be achievable over the next few years without any transfer

⁴⁹ See MCI Comments at 23.

of costs to local service."⁵⁰ The NY PSC cites several factors which should cause costs to fall. Increased demand will cause per-minute costs to fall. In addition, the incumbent LECs have proven themselves able to cut their costs by 5.3% per year. Their ability to achieve this productivity level will continue, even if competition does not occur. As competition does occur, the incumbent LECs' incentive to cut their costs will increase, and they should be able to achieve even higher productivity.⁵¹ The NY PSC estimates that, taken together, these effects could well result in 50% access rate reductions being accommodated as part of the normal course of business.⁵²

Incumbent LEC access rates are currently well in excess of economic cost. The Commission should take the steps necessary to lower these rates. Concerns that this will reduce the incumbent LECs' earnings, or result in upward pressure on local rates are unfounded. A competitive market would not allow the incumbent LECs to charge rates that are double economic cost, and the Commission should not allow the incumbent LECs to continue to do so. Now that the Commission knows the extent to which access rates exceed economic cost, the Commission is legally required under Section 201 of the

⁵⁰ See NY PSC Comments at Attachment 1, page 1.

⁵¹ Bell Atlantic/NYNEX's claims that competition will reduce productivity simply flies in the face of reality. See Bell Atlantic/NYNEX Comments at 59.

⁵² See NY PSC Comments at Attachment 1.

Communications Act to reduce access rates to cost.⁵³

**VI. THE ABSENCE OF A COMPETITIVE MARKET FOR ACCESS
UNDERMINES THE SO-CALLED “MARKET-BASED” APPROACH**

The fact that there is no market for switched access services illustrates why a market-based approach would be an arbitrary and capricious method for the Commission to rely on to fulfill its statutory obligation to establish just and reasonable rates for regulated services. Surely the Commission must recognize that an approach which tinkers with the means of collection without affirmatively lower the level of charges is not meaningful reform from the perspective of competitors or end users. This view is illustrated by the comments of state regulators and consumer advocates discussed in Section II supra.

**A. Early Indications Show Reliance on Unbundled Network
Elements to Reduce Access Charges Is Misplaced.**

The widespread concern that the market-based approach will fail to quickly reduce access charges is confirmed by attempts of MCI and other new entrants to obtain unbundled network elements and use wholesale services to provide a local service alternative.

There are a whole host of problems associated with provisioning

⁵³ 47 U.S.C. 201.

unbundled network elements.⁵⁴ In effect, the 1996 Act and the competitive checklist are an entirely new language and the new entrants seem intent to use every negotiation as an opportunity to rewrite the plain language of the 1996 Act. This makes establishing and executing a business plan virtually impossible.⁵⁵ Furthermore, some of the elements the Commission specifically mandated in the Interconnection Order last summer, such as unbundled sub-loops and the ability to combine elements are not available. The current state of Operational Support Systems (OSS) across the country, which is just one piece of the competitive checklist, illustrates the reason MCI firmly believes relying on the market to bring access down to economic cost will be ineffective over any acceptable period of time.⁵⁶

Before MCI or any other company can effectively use unbundled network

⁵⁴ As MCI noted in its initial comments, only Florida has established a permanent rate for unbundled network elements. Furthermore, in many places it is entirely unclear when the necessary cost proceedings will be completed. The uncertainty created prevents the Commission from concluding that states will set cost-based rates consistent with the statutory standard and the interests of competition.

⁵⁵ At the most basic level, firms throughout the industry seem to have very different views of what constitutes a bonafide request. Obviously, the process of establishing a competing service using unbundled network elements cannot even begin until there is some agreement on a reasonable definition. Without one, the incumbent LEC can easily use this requirement to delay and deny provisioning of unbundled network elements on a customer by customer and market by market basis.

⁵⁶ Incumbent LECs OSS requires significant amounts of manual entry for a new entrant's orders to be processed. Some companies still require orders to be faxed before they can be processed.

elements to serve customers, and even before a company can begin marketing a competing local service, systems need to be in place to guarantee efficient, electronic pre-ordering, ordering, provisioning, maintenance and repair, and billing. In many states, these systems do not even exist, and in those few places where they do exist on paper, there has been no demonstration that they can operate effectively, efficiently and consistently.

Even if MCI or another competitor were able to obtain the necessary unbundled network elements, the incumbent LECs are also using non-recurring charges as a means of discouraging competitive entry. MCI maintains that these charges are not based on forward-looking economic costs. PacBell in California, for instance, has an interim non-recurring charge of \$148.96 for ordering and connecting each two wire analog loop. There is also a \$74.99 charge to disconnect. The non-recurring charge for a two wire switch port is \$137.36. The charges just go up from there.⁵⁷ In Florida, where the rates for unbundled elements are permanent, the situation is only somewhat better. The non-recurring charge for a two wire analog loop is \$140. For switching the charge is \$38.⁵⁸

⁵⁷ MCI/Pacific Bell Arbitration - Prices for Unbundled Network Elements, Attachment 8 - Appendix A.

⁵⁸ In Re: Petitions by AT&T Communications of the Southern States, Inc., MCI Telecommunications Corporation, MCI Metro Access Transmission Services, Inc., American Communications Services, Inc. and American Communications Services of Jacksonville, Inc. for arbitration of certain terms and conditions of a proposed agreement with BellSouth

The result, is unless the new entrant can hold on to a customer for a long enough period of time, it creates an opportunity for the incumbent LEC to impose significant actual or potential losses on the new entrant. Coming from the competitive long distance industry that saw more than 50 million customer switches last year, MCI is concerned that these outrageous charges will make the use of unbundled network elements infeasible, even if the myriad OSS and other problems are corrected.

MCI is certainly not suggesting that making OSS systems operational and efficient or forcing non-recurring charges to be based on actual cost will solve the problems associated with relying on the market to bring down access charges to economic cost. Rather, it is a useful illustration of just one set of the many pieces which must fall in place just to begin to make competition via unbundled network elements possible. Furthermore, it highlights the practical failings of using anything but a pro-competitive prescriptive approach to bring access charges down to their forward-looking economic cost consistent with the Interconnection Order and the Joint Board Recommendation, when new entrants are going to remain dependent on the local network controlled by the incumbent LECs.

It is only the incumbent monopolies that claim the policy permitting entry

Telecommunications, Inc. concerning interconnection and resale under the Telecommunications Act of 1996. Docket No. 960833-TP; Docket No. 960846-TP; Docket No. 960916-TP, Order No. PSC-96-1579-FOF-TP, Issued December 31, 1996.

through the use of unbundled elements eliminates the many barriers to local competition. Each of the RBOCs attempts to ignore the fundamental difference between the legal authority to compete and actual, vigorous competition. Southwestern Bell takes the argument to its most ridiculous extreme, "Direct substitutability of unbundled elements for ILEC access services constitutes imminent 'potential,' 'actual,' and 'substantial' competition all at once."⁵⁹ Even GTE, which is leading the attempt to have the entire Interconnection Order overturned and challenging virtually every state arbitration order joins in these totally unrealistic claims which should be summarily dismissed by the Commission.⁶⁰

VII. PRICING FLEXIBILITY WILL ONLY FURTHER DELAY ACCESS CHARGE REDUCTIONS

Commenters agree that the pricing flexibility proposed by the Commission

⁵⁹ Southwestern Bell Comments at 21. See also Ameritech Comments at 30, ("Certainly with the availability of unbundled network elements, the Commission can be confident that entry barriers for the competitive provision of access services are low."); US West Comments at 27, ("With network interconnection, unbundled network elements and resale of local exchange service freely available -- and with regulatory commissions ready to field complaints of unfair treatment -- no one can credibly argue that an ILEC will have the ability to restrain the supply of exchange access, once interconnection agreements are in place.");

⁶⁰ GTE Comments at 10-11, ("The ability of new entrants to purchase unbundled network elements from ILECs at cost plus a reasonable profit is a powerful tool that is available now in every jurisdiction in the country that is not eligible for an exemption.")

will only exacerbate the flaws inherent in the market approach. Far from “intensifying” access charge reductions, as the Commission hopes, premature pricing flexibility will only slow the development of competition. Pricing flexibility permits incumbent LECs to cross-subsidize those access services most likely to face competition with continued monopoly revenues from other access services. This would limit competitive entry, and minimize the impact of competitive forces on the level of access charges.

A. Premature Pricing Flexibility Would Preempt The Development of Competition.

As MCI discussed in its initial comments and reaffirms in Section VI supra, there is no evidence that the availability of unbundled elements can place competitive pressures on LEC access services. Sprint concurs, noting that satisfaction of the Commission’s proposed Phase 1 triggers does not guarantee that entry is economically feasible or that it will actually occur.⁶¹ The Commission itself seems to recognize that unbundled elements cannot place widespread pressure on incumbent LEC access rates, suggesting that “it is likely that competitive forces should come most quickly to bear on the provision of access in low-cost geographic areas and to large customers.”⁶²

If there is only localized competitive pressure, the incumbent LECs will

⁶¹ Sprint Comments at 41.

⁶² Notice at para. 168.

have the incentive to maintain or increase access revenues where competitive entry is unlikely, in order to cross-subsidize access rates for end users they perceive as attractive to new entrants. There is no guarantee that the incumbent LECs will use their pricing flexibility to adjust their access prices to efficient levels, as the Commission hopes.⁶³ The incumbent LECs are far more likely to reduce their access charges even below cost where necessary to discourage entry by more efficient competitors. As long as competitive forces are not substantial and widespread, the incumbent LEC could preempt competitive entry while maintaining its existing revenue flows and satisfying any overall cap on their prices.

In their comments, most incumbent LECs argue that they should be granted even more pricing flexibility than the Commission has proposed, and argue that they should be granted pricing flexibility sooner than the Commission has proposed.⁶⁴ It is clear from these proposals that the incumbent LECs seek only to preempt competitive entry. For example, the incumbent LECs generally argue that they should be granted the Commission's Phase 1 pricing flexibility package as soon as a Section 252 agreement is in effect.⁶⁵ This would enable the incumbent LECs to begin targeted rate cuts before a new entrant had signed

⁶³ Notice at para. 163.

⁶⁴ See, e.g., US West Comments at 28; GTE Comments at 45.

⁶⁵ See, e.g., BellSouth Comments at 30.

up a single customer.

It is also clear that the incumbent LECs seek to target their rate reductions as narrowly as possible, in order to maintain most or all of their current revenue stream. US West, for example, requests that the Commission give it permission to deaverage its rates along whatever lines it wishes.⁶⁶ This would simply permit the incumbent LEC to target rate reductions to those areas where competition is most likely to develop first, regardless of any cost considerations.⁶⁷ Similarly, some Incumbent LECs propose to differentiate between classes of end users in Phase 1.⁶⁸ This would permit the incumbent LEC to raise access charges for residential end users, who may be less likely to have an opportunity to switch to competing providers, and use these additional revenues to fund anticompetitive rate cuts for business user access charges. The same objective underlies the incumbent LECs' proposals to modify the price cap basket structure.⁶⁹

Other incumbent LEC pricing flexibility proposals show that they wish to raise access charges where competition is least likely to develop. BellSouth and Southwestern Bell urge the Commission to permit upward pricing flexibility for

⁶⁶ US West Comments at 32.

⁶⁷ Id. ("The better approach, though, would allow the ILECs to deaverage along any geographic lines they wish. That will give them the freedom to meet competition most effectively and bring the benefits of competition to all their access charge customers most quickly.")

⁶⁸ See, e.g., Bell Atlantic/NYNEX Comments at

⁶⁹ See, e.g., USTA Comments at 50.

zone prices of ten percent, not the five percent permitted under existing rules.⁷⁰

Also, many of the proposals for pricing flexibility (e.g. volume discounts), would give the incumbent LECs unfettered ability to raise prices for some users. These changes are plainly intended to enable rate increases that would recoup any revenue losses in areas where the incumbent LEC felt itself forced to make rate cuts. There is no evidence that current access rates are below cost anywhere, for any class of customer. Indeed, BellSouth and Southwestern Bell make no attempt to argue that cost considerations justify this degree of upward pricing flexibility.

The incumbent LECs make no effort to demonstrate that there is a cost basis for any of the pricing flexibility that they propose. None of the RBOCs has attempted to demonstrate that there is a cost basis for deaveraging local switching rates. The evidence in the record suggests that there is no compelling reason for permitting geographic deaveraging of local switching rates. Sprint shows that there may be a cost basis for differentiating switches serving fewer than 10,000 lines.⁷¹ However, because most large price cap LECs' switches

⁷⁰ BellSouth Comments at 32.

⁷¹ OPASTCO presented data in CC Docket No. 80-286 (See Figures 4A and 4B in Appendix B of its Comments) that showed that the investment cost per line for switches is approximately \$200 per line whether the switch serves 10,000 lines or 40,000 lines, and that the investment cost per line for a small switch is also about \$200 per line between 3,000 and 4,000 lines, rising to \$400 per line only when the lines per switch falls to close to 1,000 lines.

serve more than 10,000 lines, deaveraging of local switching would have little or no cost basis and should be viewed only as a tactic for preempting competitive entry.

The incumbent LECs' proposals serve to illuminate their objective of preserving current revenue streams while preempting competitive entry. However, as several commenters note, the Commission's pricing flexibility proposal, while less extreme than the incumbent LECs' proposals, would not serve to "intensify" access competition.⁷² After the Commission eliminates the excess, access competition can only be intensified by ensuring that barriers to competition have been truly eliminated, as ALTS discusses in its comments.⁷³ Premature pricing flexibility, on the other hand, only makes it even more difficult for the market-based approach to achieve meaningful access charge reductions.

Incumbent LECs should not be granted additional pricing flexibility until they have lost the ability to preempt competitive entry by cross-subsidy. In particular, the Commission should not provide the incumbent LECs with additional pricing flexibility until access charges have been brought to cost through the prescriptive approach or substantial and widespread competition exists in all markets. The Commission should use the prospect of further pricing flexibility as an incentive for incumbent LECs' to bring access charges to cost,

⁷² See, e.g., ALTS Comments at 17-19.

⁷³ Id. at 5-14.

not as a strategy for achieving this objective.

B. The Commission's About-Face Is Unexplained.

Many commenters emphasize that the Commission's pricing flexibility proposals are contrary to Commission precedent. As noted by ALTS,⁷⁴ the Commission's proposal to grant incumbent LECs contract tariff authority almost immediately is inconsistent with the Interexchange Order. While the Commission withheld contract tariff authority from AT&T until it faced substantial competition, the Notice proposes to grant the incumbent LECs contract tariff authority before their competitors have signed up a single customer. As commenters note, the Notice provides no justification for abandoning the competitive test established by the Interexchange Order.⁷⁵

The availability of unbundled elements is in no respect comparable to the level of competition faced by AT&T when the Commission granted it contract tariff authority. As MCI discussed in its initial comments, the Interexchange Order relied on a finding that AT&T faced facilities-based competitors that operated on a national basis and competed successfully for a full range of services. Under the Commission's proposed Phase 1 checklist, by contrast, there would not have to be a demonstration that competitive entry was viable. Unbundled network element-based competition has not been tested. Moreover,

⁷⁴ ALTS Comments at 20.

⁷⁵ See, e.g., AT&T Comments at 76.

unbundled network elements are bottleneck facilities controlled by the incumbent LECs, while AT&T's competitors no longer relied on AT&T facilities.

Similarly, as Time Warner and others note⁷⁶, the Commission's proposal to allow geographic deaveraging of switched access rates, as well as term and volume discounts, at Phase 1 is inconsistent with the Switched Access Expanded Interconnection Order.⁷⁷ In that Order, the Commission authorized term and volume discounts when competitors had taken 100 cross-connects because this would "provide marketplace evidence that the LECs' expanded interconnection tariffs provide a viable competitive opportunity."⁷⁸ Now, in the Notice, the Commission proposes to abandon its requirement of marketplace evidence. It would permit term and volume discounts without any indication that competitive entry was feasible.

The Switched Access Expanded Interconnection Order emphasized that additional pricing flexibility should be granted through measured steps, in a "phased, orderly fashion."⁷⁹ In the Notice, however, the Commission proposes to grant virtually unlimited pricing flexibility almost immediately. The Switched

⁷⁶ See, e.g., Time Warner Comments at 30.

⁷⁷ In the Matter of Expanded Interconnection with Local Telephone Company Facilities, Second Report and Order and Third Notice of Proposed Rulemaking, 8 FCC Rcd 7374. (Switched Access Expanded Inteconnection Order)

⁷⁸ Id. at 7435.

⁷⁹ Id. at 7424.

Access Expanded Interconnection Order also emphasized that the phased introduction of pricing flexibility would create incentives for the LECs to act cooperatively in facilitating competitive entry.⁸⁰ However, by granting the incumbent LECs substantial pricing flexibility before competition has even begun to develop, the Notice proposal would only create incentives for the incumbent LECs to preempt competitive entry.

Commenters other than incumbent LECs generally agree that it is premature to begin examining whether incumbent LEC access services should be deregulated. As AT&T discusses in its comments,⁸¹ the decision to grant AT&T greater flexibility came only after substantial time and consideration of many factors. Furthermore, the incumbent LECs' claims that the availability of unbundled elements is evidence of substantial supply elasticity does not withstand scrutiny. Unbundled elements are bottleneck facilities, under the control of the incumbent. Deregulation of the type sought by the incumbent LECs' should only occur when there is widespread facilities-based competition. MCI supports the proposals of AT&T and Sprint that consideration of the deregulation of incumbent LEC access services be deferred to a future proceeding.⁸²

⁸⁰ Id.

⁸¹ AT&T Comments at 76.

⁸² AT&T Comments at 85-87; Sprint Comments at 37, 46-48.

C. RBOC Entry Into the InterLATA Market Should Limit Pricing Flexibility.

Commenters emphasize that some of the Commission's pricing flexibility proposals would not only disrupt competition in the exchange access market, but would also disrupt competition in the interLATA market.⁸³ As Sprint notes, the Commission's proposal to deregulate new services "could easily give RBOCs the flexibility to define new services in such a way that their own long distance affiliates may be the only carriers that can avail themselves of the new services."⁸⁴ Similar considerations apply to contract pricing and volume and term discounts. The RBOC could craft discount plans that, while ostensibly offered to all, may in reality have only the RBOC's affiliate as a potential customer.

The potential for discriminatory pricing of access services is sufficient grounds for limiting the incumbent LECs' pricing flexibility. The RBOCs incentive to craft tariffs that benefit their own affiliates is demonstrated by their continued advocacy of growth discounts.⁸⁵ Even if the Commission prohibits growth discounts, as it should, other forms of pricing flexibility are equally dangerous. At a minimum, the proliferation of pricing plans would seriously

⁸³ MCI maintains that such a policy would also hurt the development of local competition by allowing the incumbent LECs to discriminate in favor of their long distance affiliate. See Affidavit of Franklin Fisher (MCI 251 Replies) for further discussion of this issue.

⁸⁴ Sprint Comments at 43.

⁸⁵ See, e.g., Ameritech Comments at 42-3.